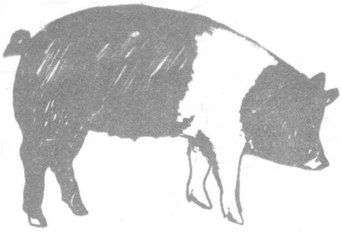

KEEPING MORE OF THE INCOME

YOU MAKE

IN THE SWINE BUSINESS 1/

Over the years, the swine industry has ridden an economic roller coaster accompanying cyclical ups and down of prices and volume of production. During the past year prices have been very favorable, in fact, the average price for all barrows and gilts at seven major markets was near $40.50 per cwt. This was over 50% higher than the previous record high of about $26.80 in 1972. It was a profit year for most pork producers in 1973. It was also a year of many frustrations due to the uncertain economic climate. Consumer boycotts, ceiling prices, and $400 per ton plus soybean meal were the main culprits.

The topic that has been given to me has three aspects over time, namely: 1) conserving as much of the gross income as net income, 2) use the latest income tax techniques to maximize the profit above taxes, not necessarily minimize taxes, and 3) reduce estate settlement costs when the final reckoning day comes.

I. GROSS TO NET INCOME

Profit in any business generally depends on three main factors, namely: price of the salable product, volume of production, and producer's costs. The price in the long run depends on the demand and the available supply of the product. Pork prices over the past year have been very favorable.

Production per man is one of the first factors to analyze in studying a farm business summary from a volume or size standpoint. This can be reflected in the

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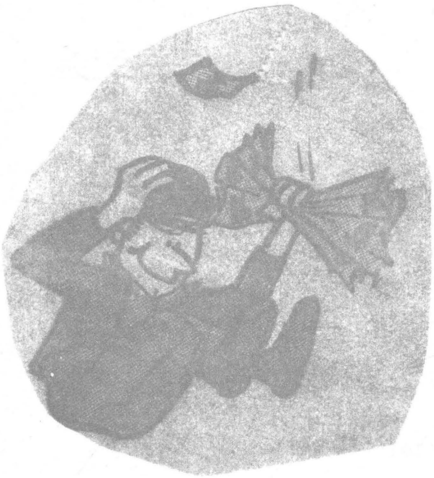
1/ Prepared by John E. Moore Extension Economist, Farm Management, Ohio State University. For the Annual Meeting of the Ohio Pork Producers, January 12, 1974 at Scotts Inn, Columbus, Ohio.

number of sows per man or pigs to market from a physical standpoint, but eventually it is considered from a gross income per man basis.



An important step in keeping more of the income you make is to gain a clearer knowledge and control of your actual costs; so more net profit can be saved. The familiar family budget saying, "It is not the high cost of living that is the problem, but the cost of living high" can be true in some farm businesses. Costs have gone up the past year and it is essential that we develop a procedure to detect costs that are essential and cannot be reduced, but more importantly detect costs that can be reduced. It is also important to have a procedure or basis for committing capital to investments. Once you commit capital to buildings and machinery, the only alternative left to reduce overhead cost is to intensify the use of these assets. This is the area of costs, that the "living high" expression is appropriate for some farm businesses. High product price periods sometimes encourages us to over commit capital to long time investments. Time spent in analyzing alternative use of investment capital based on long range prices is very important. As you will note in the following illustration of the latest Ohio Farm Business Analysis report that the top 50 percent profit-wise farmers had only 25 percent of their gross income absorbed by overhead costs while the low 50 percent had over 42 percent of their gross absorbed by depreciation, interest, repairs, taxes and insurance.

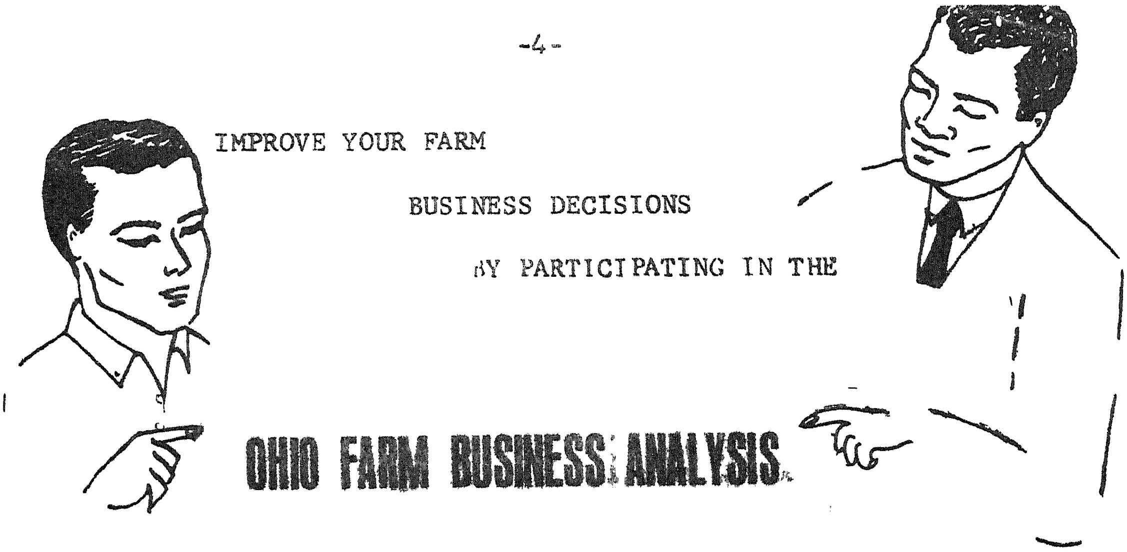
ILLUSTRATION 1:

DISTRIBUTION OF GROSS INCOME ON OHIO SWINE FARMS ANALYZED IN 1972

Top 50% | Low 50%

$79,883 Gross Income Per Farm | $33,557 Gross Income Per Farm

One of the quickest ways to find strengths and weaknesses in a hog operation is to determine your cost to produce a cwt. of pork and compare it with the results given in the enterprise Ohio Farm Business Analysis summary. It shows for 1972 that the total expense per cwt. for farrow and finish operations ranged from \$20.53 for the top 25% of the farms, to \$33.09 for the low 25% of the farms. The finishing only enterprises had total expenses for finishing market hogs of \$16.23/cwt. for the top 25% of the farms, and \$25.64/cwt. for the low 25% of the farms. Costs have gone up considerably, but the fact still remains that there is a wide variation in the cost of production between pork producers.



By putting forth just a little more effort than the minimal records needed for income tax purposes you can have a business record that can be analyzed for a keener insight for decision making. With more attention on year-end inventories and quantities of home grown crop production feed to livestock, coupled with cash receipts and expenses you have the basis for a very comprehensive business analysis. Turn these records in on a computer input form 7363 (Ohio Farm Business Analysis) by way of your county agent, vocational agriculture teacher or area extension farm management agent and the Department of Agricultural Economics, Ohio State University can supply you with a computer printout that will give you many performance factors that will give you a clearer picture and control of your actual costs. This aids you in doing some fine tuning or current adjustments in your business planning for another year. The more years of computer analysis you complete, the more accurate your allocations become between enterprises and the more valuable the procedure becomes for improved decision making.

II. INCOME TAX MANAGEMENT

Think taxes the year around. Understand the tax effects of your business actions.

Good tax management means paying no more than the legal minimum taxes over a period of time. However, minimizing tax payment may not be as worthy a a business objective as maximizing income above taxes. For example, buying a $20,000 combine may help minimize taxes but if you do not have adequate acres of use, it may not maximize income above taxes.

Many of your income tax management options are gone once the year-end bell chimes, but as of January 12--the following are a few tax tips:

1. Record all possible authorized cash expenses including wages paid actual paid children for productive work.

2. Include all depreciation expenses. Choose the depreciation method best fitted for your needs. In years of high income use accellerated methods for your new purchases like double declining balance. Additional 20 percent first year depreciation can be taken in addition to your other selected method, on the cash difference of a trade-in or total value of a direct purchase, if depreciation useful life is six years or longer.

3. Investment credit is a top tax saving tip; so don't overlook filing for all eligible credit. Any purchase made of machinery, new or used, that will be used by you for three years or more can win you a "refund" of taxes due of up to 7 percent of the purchase price. It has to have a useful life of at least 7 years to earn the full 7 percent tax credit. A few other things like silos, grain bins, tile and fence can also qualify.

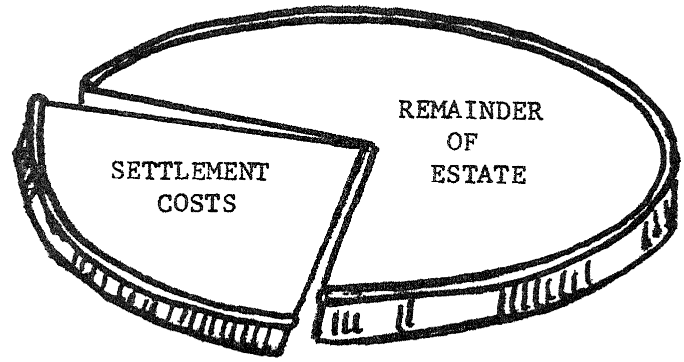
4. Remember to include Federal and State gas refunds or credit. It is last year's federal gas credit that is this year's income.

5. Income averaging may be a good possibility, if your 1973 taxable income is 120 percent plus $3,000 above the average taxable income of the prior four years. Capital gain income is includable in addition to earned income, wages, etc.

6. Document the expenses for the business use of a portion of your residence for office use if space is set aside for this purpose and good records are kept.

7. New farm purchase should be allocated between land, dwelling, depreciable improvements, investment credit eligible property, and value of growing crops, if any.

There should not be any conflict between wise tax decisions and good farm management decision. If you purchased a capital asset to minimize taxes and you really do not have adequate use of the item from a farm management standpoint you are only kidding yourself.



III. REDUCE ESTATE SETTLEMENT COSTS BY PLANNING

Successful Ohio pork producers are becoming more concerned about the shrinkage of their life savings at estate settlement time. Taxes can either be collected in the form of income taxes, gift taxes, or estate taxes.

Uncle Sam is a patient collector. You can do an excellent job of minimizing income taxes by making improvements on your farm or buying machinery that can be depreciated and possibly in some cases be eligible for investment credit. At the same time your net worth is growing faster than you may realize due to the added capital assets, plus the rapid appreciation of land values. Without proper planning action toward inter-generation farm transfer a sizable shrinkage can take place in your net worth at estate settlement time. This is the last time your total tax program is reviewed. Maximizing current income above taxes is an important short-time objective, but preventing excess estate settlement costs is another important long time objective,

The four main estate settlement costs are: 1) executor or administrator fees, 2) legal fees, 3) Ohio estate taxes, and 3) Federal estate taxes.

Can you answer questions like the following: What exemptions are permissable in calculating Ohio and Federal Estate taxes? Is insurance included in your gross estate? What expenses can be deducted? Do you realize that from 12 percent on the smallest estate to over 40 percent on the estates over $200,000 is absorbed by taxes and other settlement costs.

An estate plan is very individualized. What fits one family may not fit another family. Both husband and wife should be involved in the planning. It is tragically true that most women have too little knowledge and understanding of their family business affairs. This is why the wife should be present when estate planning is discussed.

Estate planning is for the experts--choose a competent team. Your lawyer should be one who has specialized knowledge in estate planning. He will need all the facts about your property. You may want your insurance man, accountant, banker or a trust officer from your bank to help, too. Your extension agent and/or area farm management agent may also be able to make suggestions.

Some of the basic home work that needs to be done before taking the time of outside advisors is:

1. Make an inventory of all your assets at the present market value including insurance policies of which you own.

2. List a few objectives you want to accomplish by an estate plan. For example, who should receive what if you should die, if both you and your wife are in a common accident, etc.

3. List the number and age of your children. Also the occupation and particular needs of each.

4. What amount of income is needed for the present family income security and how much income is your business now generating.

Objectives vary with the family, but here are some of the more common ones:

1. To provide sufficient income for the parents during the rest of their lives
2. To treat all children equitably, not necessarily equally
3. To help one or more of the children start farming

4. To keep the farm within the family

5. To maintain continuity in farming operations between generations without dispersing the herds, flocks, land and improvement built up over a lifetime

6. To reward certain children for special favors or contributions to parent's welfare or for improvements of the farm

7. To indicate to prospective heirs what to expect relatively early in life so they can plan their lives accordingly

8. To minimize estate settlement costs

9. To minimize all taxes to the family, including gift, inheritance, estate and income taxes.

There are many alternative methods used in transferring property to the next generation. Three general categories are:

1. A "Will" with all property transferring at death.

2. By sale and or gift--where a certain amount of the property is transferred during your lifetime.

3. "No Action" or the Ohio Law of Decent and Distribution is the plan that is followed.

So there is no such thing as no plan or method for your estate settlement. If you don't develop your own plan, your property will be distributed according to the law of Ohio. This is particularly a sad plan when a young farmer with two or more children is taken unexpectedly. The law says the wife only receives one-third and the children receive two-thirds. The two-thirds is distributed under the supervision of the probate court until the children are of age. This expense and inconvenience can be saved by a simple "Will".

There are several different alternative methods or combination of methods that can be used. A few of these are: 1) "Will"--this is a basic method and nearly everyone over eighteen years of age that owns any property should have a "Will". 2) Insurance--an important estate planning tool. 3) Conditional or installment sales. 4) Annuities. 5) Trusts. 6) Partnership. 7) Incorporations.

8) Gifts.

Providing income security for the parents is a primary objective, but total family satisfaction is a close second. Once you understand the progressive tax structureof income tax, state and federal estate taxes, and gift taxes and analyze your net worth you will probably use a combination of the methods listed.

The heaviest estate tax is levied generally when the second spouse passes away if there is no planning. Each individual has a $60,000 exemption, but if a spouse remains and the deceased has "willed" 50 percent or more of the assets to the remaining spouse, then there is a "marital" deduction of 50% in addition to the $60,000 individual exemption. The remaining spouse upon death does not have the marital deduction and only has the $60,000 individual exemption. Federal estate tax is levied at the rate starting at 3% up to 32% on $250,000 to $500,000 estates and goes higher. For esample, on a net taxable estate of $250,000 you would be at the taxable rate of 32% for federal, 7% for state, 2% executor's fees, and possible 3% for legal fees or a total of 43% shrinkage.

Many farmers are realizing that much of the income they made during life cannot be distributed to their children at death due to the settlement costs. At this realization many questions are being asked about gift taxes, etc.

It is true the only way you reduce excessive settlement cost is to not have the assets in your estate at death. Gift tax is levied on property transfer during the owner's lifetime. Each person can give tax free:

1. $30,000 once in a lifetime

2. $3,000 annually to as many different individuals as you so desire

3. Husband and wife together could give $60,000 once in a lifetime and and $6,000 annually to each beneficiary.

The $3,000 annually is in addition to the lifetime exemption. The value of the gifts given the three years just prior to death maybe included in your estate unless a gift program has been underway for a longer period or your legal advisory can prove it was not given in contemplation of death. Gift taxes are never more than 75% of federal estate taxes starting at 2.25% and at the 22.5% rate at $100,000.

The farm business has assets in undivisible quantities that makes the job more difficult than many other types of estates, but with proper planning you can keep a much higher percent of the money you make for your family.

In summary, you can save more of the money you handle by improving your current financial farm management decision making, maximize net income above income taxes, and finally plan to reduce estate costs for the longtime family welfare.